



73RD ANNUAL STATE CONTROLLER'S CONFERENCE WITH COUNTY AUDITORS

**Riverside County
October 24-26, 2018**

LEASES GASB STATEMENT No. 87

GASB STATEMENT No. 87, LEASES

AGENDA

GENERAL SESSION:

- Background
- The Foundation Principle
- Standards of Governmental Accounting and Financial Reporting

BREAKOUT SESSION:

- Illustrations of Governmental Accounting and Financial Reporting
- Lessee and Lessor Accounting and Reporting



GASB STATEMENT No. 87, LEASES

BACKGROUND

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CURRENT STANDARDS

- Accounting Principles Board (APB) Opinion No. 5, Reporting of Leases in Financial Statements of Lessee (1964).
- FASB Statement No. 13, Accounting for Leases (1976).
- National Council on Governmental Accounting (NCGA). Statement 1, Governmental Accounting and Financial Reporting Principles (1979) stated that FASB Statement No. 13 was applicable to governmental units.
- In 2006 FASB and the International Accounting Standards Board (IASB) started a joint project to reexamine guidance for leases.
- Leases project added to GASB current technical agenda. (2013)

- **GASB processes regarding leases were:**
 - Preliminary views (2014) and field testing
 - Public hearings (2015)
 - Exposure draft (2016)
 - Assembled a task force
 - Statement issued (2017)

CURRENT ACCOUNTING

- Current lease standards provide criteria for distinguishing between operating and capital leases. A lease is a capital lease if it meets any of the following criteria:
 1. The lease transfers ownership of the property to the lessee by the end of the lease.
 2. The lease contains an option to purchase the leased property at a bargain price.
 3. The lease term is equal to or greater than 75 percent of the estimates economic life of the leased property.
 4. The present value of rental or other minimum lease payments equals or exceeds 90 percent of the fair value of the leased property less any investment tax credit retained by the lessor.

This distinction is important because the accounting for operating and capital leases is very different.

- **Capital Leases**

A government lessee in accrual-based financial statements report the leased asset as a capital asset, balance by a long-term liability. The amount of the asset and liability is equal to the present value of the future lease payments. The government lessor recognizes a long-term lease receivable related to the future lease payments and removed the asset from its financial statements.

In the governmental funds, reporting on a modified accrual basis, capital assets and long-term liabilities are not reported. Rather, when a lease is entered into the government reports an expenditure equal to that present value amount and an other financing source-capital lease agreement

- **Operating Leases**

Unlike capital leases, no capital assets, long-term receivable, or long-term liabilities are reported at the inception of an operating leases as reported each year as expenses/expenditures and revenues.



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THE FOUNDATIONAL PRINCIPLE

FOUNDATIONAL PRINCIPLE

- The accounting and financial reporting guidance for leases in the Statement is based on The Foundational Principle that leases are financings. In a lease transaction, a lessee receives the legal right to use an underlying asset (such as a vehicle or building) at the commencement of the lease term. In exchange, the lessee promises to make payments over time for the right to use that underlying asset. Therefore, the lessee has financed the acquisition of that legal right. Conversely, a lessor received payments over time for transferring to the lessee the legal right to use the underlying asset.
- GASB concluded that a single approach that accounts for leases based on that common financing element should be required.

UNIFIED REPORTING MODEL FOR LEASES

- No classification of leases into operating/capital or other categories
- Underlying assumption that leases are financings
- Exceptions (lessors and lessees)
 - Short-term leases
 - Leases that transfer ownership and do not contain termination options
- Exceptions for lessors
 - Leases of assets that are investments
 - Certain regulated leases (e.g., airport-airline agreements)



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STATEMENTS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

SCOPE

- Establishes standards of accounting and financial reporting for leases by lessees and lessors.
- This statement applies to financial statements of all state and local governments.
- Definition of a lease: “A lease is a contract that conveys control of the right to use another entity’s nonfinancial asset (the underlying asset) for a period of time in an exchange or exchange-like transaction.”
 - The right-to-use asset is that “specified in the contract”
 - Control requires (1) the right to obtain present service capacity from use of the underlying asset and (2) the right to determine the nature and manner of use of the underlying asset
- Leases are financings of the right to use an underlying asset
 - Therefore, single approach applied to accounting for leases with some exceptions, such as short-term leases

LEASE TERM

- For *financial reporting*, when does the lease start and end?
 - Starts with the noncancelable period, plus periods covered by lessees' and lessors' options to:
 - Extend the lease, if the option is *reasonably certain* of being exercised
 - Terminate the lease, if the option is *reasonably certain* of NOT being exercised
 - Excludes “cancelable” periods
 - Periods for which lessee and lessor each have the option to terminate or both parties have to agree to extend
 - Rolling month-to-month leases
 - Fiscal funding/cancelation clauses ignored unless *reasonably certain* of being exercised

SCOPE EXCLUSIONS

- Intangible assets (mineral rights, patents, software, copyrights), except for the sublease of an intangible right-to-use asset
- Biological assets (including timber, living plants, and living animals)
- Inventory
- Service concession arrangements (Statement 60)
- Assets financed with outstanding conduit debt, unless both the asset and the debts are reported by the lessor
- Supply contracts (such as power purchase agreements that do not convey control of the right to use the underlying power generating facility)

SHORT-TERM LEASES

- At the beginning of lease, maximum possible term the contract is 12 months or less, including any option to extend regardless of their probability of being exercised
- Lessees recognize expenses/expenditures based on the terms of the contract
 - Do not recognize assets or liabilities associated with the right to use the underlying asset for short-term leases
- Lessors recognize lease payments as revenue based on the payment provisions of the contract
 - Do not recognize receivables or deferred inflows associated with the lease

WHY ARE SHORT-TERM LEASES IMPORTANT?

- LESSEE- lease payments recognized as expenses/expenditures based on the payment provisions of the contract
 - No recognition of assets or liabilities associated with the right to use the underlying asset for short-term leases
- LESSOR- lease payments recognized as revenue based on the payment provisions of the contract
 - No recognition of receivables or deferred inflows associated with the lease
- No resource flows recognized during rent holiday periods
- No required disclosures

NOTES TO FINANCIAL STATEMENTS - LESSEES

- General description of leasing arrangements
- Total amount of lease assets (by major classes of underlying assets), and the related accumulated amortization
- Amount of outflows of resources recognized for the period for variable payments and other payments (such as residual value guarantees or penalties) not previously included in the measurement of the lease liability
- Principal and interest requirements to maturity for each of the next 5 fiscal years and in 5-year increments thereafter
- Commitments under leases that have not yet begun (other than short-term leases)
- Components of any net impairment loss recognized on the lease asset during the period.

NOTES TO FINANCIAL STATEMENTS - LESSORS

- General description of leasing arrangements
- Total amount of inflows of resources (such as lease revenue and interest revenue) if not otherwise displayed
- Amount of inflows of resources recognized for the period for variable payments and other payments (such as residual value guarantees or penalties) not previously included in the measurement of the lease receivable
- The existence, terms, and conditions of options by the lessee to terminate the lease or abate payments if the lessor government has issued debt for which the principal and interest payments are secured by the lease payments



OTHER ACCOUNTING AND REPORTING PROVISIONS

LEASE INCENTIVES

- Lease Incentives-reduce the amount lessee has to pay
 - Payments made to, or on behalf of, the lessee. for which there is a right of offset
 - Other concessions
- Payments provided at or before inception of lease reported as
 - Direct reductions of lessee's lease asset
- Payments provided after inception of lease reported as
 - Reductions of payments for period provided
 - Reduces PV of lease liability (and lessor's receivable)

CONTRACTS WITH MULTIPLE COMPONENTS

- Separate contracts into lease and nonlease components or multiple lease components
- Allocate consideration to multiple underlying assets if:
 - Differing lease terms, or
 - Are in differing major asset classes for disclosure
- Allocation process:
 - First - use any prices for individual components if price allocation not unreasonable based on contract terms and professional judgment (maximizing observable information)
 - If no prices or if not reasonable, use best estimate based on professional judgment (maximizing observable information)
 - If not practicable to determine best estimate, may account for components as single lease unit

CONTRACT COMBINATIONS

- Contracts entered into at or near the same time with the same counterparty should be considered part of the same lease contract if either of the following criteria is met:
 - The contracts are negotiated as a package with a single objective
 - The amount of consideration to be paid in one contract depends on the price or performance of the other contract
- Combined contract then subject to multiple components guidance

LEASE MODIFICATIONS AND TERMINATIONS

- Result from amendments to lease contract, not from exercising options in that contract

MODIFICATIONS

- Considered lease modification unless lessee's right to use underlying asset decreases

TERMINATIONS

- Considered partial or full lease termination if lessee's right to use underlying asset decreases

LEASE MODIFICATIONS

- Report as **new lease** by both lessor and lessee if
 - New assets are added and
 - Not unreasonably priced
- Otherwise, **remeasure** as discussed on following slides

LEASE MODIFICATIONS FOR LESSEES

- Remeasure the lease liability on the effective date of modification
 - Assess the need for an updated discount rate
- Adjust the right-of-use asset by the difference between the modified liability and the liability immediately before the modification
 - If asset reduced to \$0, any additional reduction is reported as a gain
- If change results from the lessor refunding related debt and passing savings on to the lessee, see remeasurement guidance in paragraph 74

LEASE MODIFICATIONS FOR LESSORS

- Remeasure the lease receivable on the effective date of modification
 - Assess the need for an updated discount rate
- Adjust the deferred inflow of resources by the difference between the modified receivable and the receivable immediately before the modification
 - However, to the extent any change relates to payments for the current period, recognize in current period flows statement (for example, revenue)
- If change results from refunding related debt and passing savings on to the lessee, see remeasurement guidance in paragraph 76

LEASE MODIFICATIONS FOR LESSEES

- For partial/full lease terminations (other than purchases), lessees reduce/remove the lease asset and obligation
- Recognize the difference as a gain or loss
- If the lessee purchases the underlying asset, reclassify to the appropriate asset class
 - Adjust lease liability to reflect the payments yet to be made; reflect adjustment in cost of the purchased asset

LEASE MODIFICATIONS FOR LESSORS

- For partial/full lease terminations (other than sales), lessors reduce/remove the lease receivable and related deferred inflow of resources
- Recognize the difference as a gain or loss
- If the lessor sells the underlying asset, derecognize underlying asset
 - Include in the calculation of any gain or loss

SUBLEASES

- Accounted for as transactions separate from the original lease
 - Do not offset original lease liability and sublease receivable
- Disclosures for original lessee (now the lessor)
 - Include subleases in the general description of lease arrangements
 - *Lessor* transactions related to subleases should be disclosed separately from the original lessee transactions

SALE-LEASEBACKS

- Qualifying sale required (otherwise it is a borrowing)
- Accounted for as two separate transactions-a sale transaction and a lease transaction-except that
 - Any gain or loss on sale portion deferred and recognized over term of leaseback (but immediately recognize if leaseback is short-term lease)
- If terms are significantly off-market, report based on the substance of the transaction, for example:
 - Borrowing, Nonexchange transaction, Advance lease payment
- Disclose terms and conditions of sale-leaseback

LEASE-LEASEBACKS

Example: A school district leases land to a developer. The developer builds a school and leases the school and land back to the school district.

- Accounted for as a net transaction (because of right of setoff)
- Disclose (both parties)
 - Gross amounts of the lease and the leaseback

INTRA-ENTITY LEASES

- Leases with/between blended component units
 - Eliminations for internal leasing activity take place before the financial statements are aggregated
- Leases with/between discretely-presented component units
 - Treat like normal leases, but
 - Present receivables and payables separately

LEASES BETWEEN RELATED PARTIES

- Recognize substance of the transaction, when substance is significantly different from legal form
 - For example, a short-term lease is long-term if parties have an understanding that lease will be extended several years
- Use equity method for investments in stock
- Disclose the nature and extent of related-party leases

EFFECTIVE DATE AND TRANSITION

- Effective for periods beginning after December 15, 2019
 - Earlier application encouraged
- Transition
 - Apply retroactively
- Restate if practicable, cumulative effect if not
 - Leases recognized and measured *using the facts and circumstances that exist at the beginning of the period of implementation* (hindsight)
 - Lessors should not restate the assets underlying their existing sales-type or direct financing leases
- Any residual assets for those leases would become the carrying values of the underlying assets

EFFECTIVE DATE

- Effective date is periods beginning after December 15, 2019 (June 30, 2021)



Questions / Comments?



GASB STATEMENT NO. 87, LEASES

ILLUSTRATIONS OF GOVERNMENT ACCOUNTING AND FINANCIAL REPORTING

IMPLEMENTATION IDEAS

- Start reviewing existing leases as soon as possible
- Implement internal controls to identify leases and lease modifications
- Update accounting systems for new information needs
- Consider impact on capitalization policy
- Consider effects of reporting lease liabilities on-
 - Debt limitations
 - Bond covenants
 - Grant agreements

LEASES OVERVIEW – INITIAL REPORTING

	Assets	Liability	Deferred Inflow
LESSEE	Intangible asset (right to use underlying asset)– value of lease liability plus prepayments and initial direct costs that are ancillary to place asset in use	Present value of future lease payments (incl. fixed payments, variable payments based on index or rate, reasonably certain residual guarantees, etc.)	NA
LESSOR	<ul style="list-style-type: none"> • Lease receivable (generally including same items as lessee liability) • Continue to report leased asset 	NA	Equal to lease receivable plus any cash received up front that related to a future period

LEASES OVERVIEW – INITIAL REPORTING

	Assets	Liability	Deferred Inflow
LESSEE	Amortize the intangible asset over shorter of useful life or lease term	Reduce by lease payments less amount for interest expense)	NA
LESSOR	<ul style="list-style-type: none"> • Depreciable leased asset (unless indefinite life or required to be returned in its original or enhances condition) • Reduce receivable by lease payments (less payment needed to cover accrued interest) 	NA	Recognize revenue over the lease term in a systematic and rational manner



LEASEE ACCOUNTING AND REPORTING

LEASEE – RECOGNITION AND MEASUREMENT

- Recognize a liability for future lease payments and an intangible capital asset for the right to use the underlying asset (the "lease asset")
- In governmental funds:
 - Report payables when due
 - Do not report intangible assets

LEASEE – INITIAL MEASUREMENT

- Initial measurement of a lease liability includes:
 - Fixed payments (less any lease incentives receivable from the lessor)
 - Variable payments based on an index or rate (such as CPI), using the rate as of the beginning of lease
 - Variable payments that are fixed in substance
 - Residual value guarantees *reasonably certain* of being required
 - Purchase options *reasonably certain* of being exercised
 - Termination penalties, if lease term reflects lessee exercising termination options/fiscal funding clauses
 - Any other reasonably *certain* payments

LEASEE – INITIAL MEASUREMENT (CONTINUED)

- Lease liability does not include lease payments that are dependent on a lessee's performance or usage of an underlying asset
- Lease liability payments discounted using the rate the lessor charges the lessee (may be implicit) or, if that rate cannot be readily determined, the lessee's incremental borrowing rate

LEASEE – SUBSEQUENT RECOGNITION AND MEASUREMENT

- Lease liability reduced for actual payments less amortization of discount on lease liability (interest expense)

- EXAMPLE:

Interest expense	\$ 4,000
Lease liability	\$18,000
Cash	\$22,000

(To record cash payment, interest expense, and reduction of liability.)

LEASEE – SUBSEQUENT RECOGNITION AND MEASUREMENT (CONTINUED)

- Remeasure lease liability when certain changes occur (if expected to significantly affect liability measurement)
- If liability remeasured
 - Adjust liability for change in variable payments index/rate
 - Update discount rate when certain other judgments change
- Adjustments to the lease liability generally should adjust the lease asset by the same amount
 - Exception if adjustment is greater than carrying value of asset, difference is recognized in the flows statement

LEASEE – LEASE ASSET

- Lessee's right-to-use lease asset
 - Initially measure lease asset as the sum of:
 - a. Initial lease liability
 - b. Any prepayments (amounts paid for the lease prior to measuring the lease liability)
Less any incentives received from the lessor
 - c. Initial direct costs that are necessary ancillary charges to place the leased asset into use
Other initial direct costs (for example insurance legal. administrative) should be expensed

LEASEE – LEASE ASSET (CONTINUED)

- Lease asset subsequent recognition and measurement
 - Lease asset amortized (for example, amortization expense) using a systematic and rational manner over the shorter of the useful life of the underlying asset or the lease term
 - Lease asset amortization may be combined with depreciation expense for other capital assets
 - If the lease has a purchase option which is reasonably certain of being exercised, amortize over the useful life of the underlying asset as if the lessee owns the underlying asset, using the lessee's depreciation policy, unless non-depreciable.

LEASEE – LEASE ASSET (CONTINUED)

- Lease asset subsequent recognition and measurement (Continued)
 - Lease asset generally adjusted by the same amount as lease liability.
 - If this change reduces the carrying value of the lease asset to zero, any remaining amount is a gain
 - If the underlying asset becomes impaired, apply capital asset impairment guidance of Statement 42 to the right-to-use lease asset

LEASEE – DISCLOSURES

- A general description of leasing arrangements, including
 - Basis, terms, and conditions, on which variable lease payments are determined
 - Existence, terms, and conditions, of residual value guarantees provided by the lessee
- Total amount of assets recorded under leases, and the related accumulated amortization, disclosed separately from other capital assets
- Lease assets disaggregated by major classes of underlying assets, disclosed separately from other capital assets
- Variable lease payments recognized during the period but not previously included in the lease liability

LEASEE – DISCLOSURES (CONTINUED)

- Other payments recognized during the period but not previously included in the lease liability (such as residual value guarantees or penalties)
- A maturity analysis of all future lease payments
 - Payments for each of the first five years
 - Payments in five-year increments thereafter
 - Show principal and interest separately
- Lease commitments, other than short-term leases, for which the lease term has not yet begun
- Components of any net impairment loss (gross impairment loss less change in lease liability)



LESSOR ACCOUNTING AND REPORTING

LESSOR – RECOGNITION AND MEASUREMENT

- Recognize a lease receivable and deferred inflow of resources
- Do not derecognize the underlying asset and do not recognize a residual asset
 - Depreciate underlying asset as normal, unless required to be returned in its original or enhanced condition or has an indefinite useful life
- In governmental funds, report lease receivable and deferred inflow of resources
 - Recognize deferred inflow of resources as revenue when "available"

LESSOR – INITIAL MEASUREMENT

- Initial measurement of a lease receivable includes:
 - Fixed payments Variable payments that depend on an index or rate (such as CPI)
- Use the rate as of beginning of lease
 - Variable payments that are fixed in substance
- Exclude variable lease payments that are dependent on a lessee's performance or usage of an underlying asset
 - Residual value guarantees that are fixed in substance
 - Less provision for uncollectible amounts

LESSOR – INITIAL MEASUREMENT (CONTINUED)

- Discount the lease receivable using the rate the lessor charges the lessee
 - Interest rate may be implicit in the lease
- Initially excludes the following
 - Residual value guarantees that are not fixed in substance should be recognized as a receivable when
- Payment is required, and
- Amount can be reasonably estimated
 - Purchase option payments or termination penalties
- Recognized when exercised

LESSOR – DEFERRED INFLOW OF RESOURCES

- Deferred Inflow of Resources - Initial Measurement
 - Receivable amount, plus
 - Any cash received up front that relates to future periods (for example, final month's rent)
- Recognize revenue over the lease term on a systematic and rational manner over the lease term

LESSOR – SUBSEQUENT RECOGNITION AND MEASUREMENT

- Recognize amortization of the discount on the lease receivable (interest revenue) to produce a constant periodic rate of return on the receivable
- Lease payments allocated first to accrued interest receivable and then to the lease receivable
- Remeasure the lease receivable and update the discount rate when one or more of the following occur and are expected to *significantly* affect the receivable amount:
 - a. There is a change in lease term, or
 - b. There is a change in rate the lessor charges the lessee
 - c. A contingency is resolved making variable payments fixed

LESSOR – SUBSEQUENT RECOGNITION AND MEASUREMENT (CONTINUED)

- If remeasured, also remeasure for changes in an index/rate used to determine variable lease payments
- If the discount rate is updated, the receivable should be adjusted using the revised rate
- The deferred inflow of resources generally adjusted by the same amount as the lease receivable

LESSOR – EXCEPTIONS

- The following transactions do not apply the general lessor recognition and measurement guidance (but still required to provide certain disclosures)
 - Leases of tangible assets that are investments, No lease receivable reported for leased investment assets because investments are reported at fair value
 - Certain regulated leases (for example, airport-airline agreements)
 - Airport-airline agreements have features that don't operate like financings

LESSOR – DISCLOSURES

Lease activities may be grouped for disclosure purposes

- A general description of leasing arrangements
 - The basis, terms, and conditions on which variable lease payments not included in the lease receivable are determined
- The total amount of inflows recognized in the reporting period related to leases, if not displayed on face of financials

LESSOR – DISCLOSURES (CONTINUED)

- The lease inflows related to variable lease payments and other payments not previously included in the lease receivable
 - Include inflows related to residual value guarantees and termination penalties
- If lease payments secure lessor's debt:
 - The existence, terms, and conditions of options by the lessee to terminate a lease or abate lease payments
- Similar disclosures required for certain regulated leases (airport-airline agreements)

LESSOR – DISCLOSURES (CONTINUED)

- If government's principal ongoing operations consist of leasing to other entities:
 - Disclose maturity analysis of all future lease payments included in lease receivable
 - Payments for each of the first five years
 - Payments in five-year increments thereafter
 - Show principal and interest separately



Questions / Comments?